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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

The Dollar Takes a Tumble

Although the stock and bond markets continue to meander in a generally sideways direction, the same can no longer be said of the foreign exchange market (Financial Digest–October 7, 1988). After fluctuating within relatively narrow ranges during much of the summer, the dollar broke decidedly lower over the past two weeks, depreciating by some five percent against the Japanese yen and by nearly three percent versus the German mark. In a nutshell, the decided, and sudden, shift in market psychology from dollar bullishness to bearishness was prompted by mounting evidence of a slowing economy, fast-fading expectations of higher interest rates and a widening of the trade deficit in August. These developments diminished both the dollar's "high-yield" and "fundamental" allures.

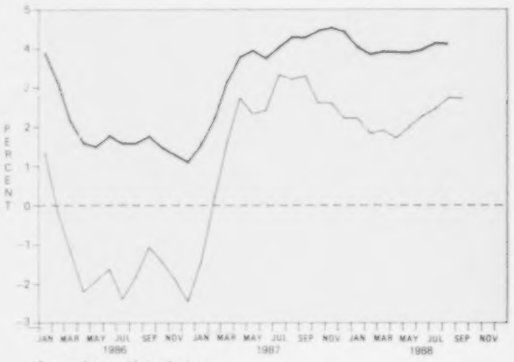
The immediate catalyst for the dollar sell-off, which reversed most of its early-summer gains, was the release of the September employment report. According to the Labor Department, total nonfarm payroll employment chalked up a seemingly solid 255,000 person gain in September, or just slightly below general expectations. However, it was not the overall number which triggered a rethinking of the economy's presumed vigor and the likelihood of higher interest rates, but rather the distribution of last month's employment increase and the sizable downward revision of the initial estimate of the number of jobs created in August–both of which indicated a further slowing of the economy.

With nearly 100,000, or some two-fifths of the September jobs increase occurring in state and local governments, largely public school teachers, and manufacturing employment easing for the second month in a row, fears that a severely labor- and capacity-constrained manufacturing sector would soon be contributing to upward price pressures seemed more exaggerated than ever. What is more, the 50,000 person, or better than 20 percent, downward revision of initial estimates of payroll employment growth in August suggested that economic activity in that month was even weaker than originally thought.

Monetary Policy Outlook in Transition

Nor were the employment numbers the only signs that the economy was at least temporarily losing some of its forward momentum. Among the others were such recent economic statistics as September retail sales, industrial production and factory operating rates, all of which are now unambiguously signaling the same thing.

12-MONTH PERCENT CHANGES:
CPI (THICK) VS. PPI (THIN)



Source: Bureau of Labor Statistics

To be sure, a cooling economy lengthens the odds that the Federal Reserve will be tightening monetary policy again–expectations of which had buttressed the dollar's external value until a week or so ago. But, it isn't the only thing. So does the fact that the inflation rate remains in check. As shown in the chart, the rates of both producer and consumer price inflation have changed little over the past year and, with oil prices slumping, industrial commodity prices topping out and wage growth remaining restrained, may even ease in the months ahead. Taken together, diminished inflation pressures and a more subdued pace of business at least raise the possibility that the next turn of the monetary policy dial may be toward ease, as opposed to restraint.

Manufacturers Hanover Economics Department 17/270

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The Trade Deficit Widens

The dashing of higher interest rate expectations triggered the initial dollar slide. The widening of the trade deficit in August reinforced it. For while the economic tempo may be slowing sufficiently to put a lid on interest rates, it has not cooled enough to put a cap on imports. Paced by a sizable upturn in consumer and capital goods imports, total imports rose to a record monthly level of $39.7 billion in August, and the trade deficit widened to a seasonally adjusted $12.1 billion in the month. This was far above the July red-ink total of $9.5 billion.

The uneven pace of trade balance improvement, especially with Japan, again fueled speculation that the dollar will have to move decidedly lower in coming months in order to narrow the trade gap further. While this line of reasoning ignores the fact that exports, too, surged to a record level in August, that trade with Western Europe, outside of Germany, is generally in balance and that the run-up in oil imports in August was probably a one-shot development, as purchasers stocked up in the wake of slumping prices, it is making the rounds and is unlikely to recede until the monthly deficits begin to narrow again.

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/5/88)	194,313	+ 1,460	+ 14,687
New York City (10/12/88)	40,030	+ 90	+ 1,402
Commercial Paper (10/12/88)	423,921	– 112	+ 62,284

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/5/88)	298,747	+ 2,205	+12,151
New York City (10/12/88)	56,370	+ 440	– 2,741

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/5/86)	899,084	+ 4,373	+42,435
New York City (10/12/88)	172,801	+ 2,067	– 4,565

Financial Markets

	Friday 10/21/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.68%	+ .14	+ 2.34
180-Day Bills†	7.98	+ .19	+ 1.82
Longest Bills†	8.13	+ .09	+ 1.22
Recent Issues:			
81/2S 9/30/90	8.35	+ .06	
83/4S 9/30/92	8.50	+ .05	
91/4S 8/10/98	8.82	+ .03	
91/8S 5/15/18	8.90	+ .02	
Municipals:			
Bond Buyer–20 Bond Index* (10/20/88)	7.45%	– .07	– 1.27
Blue List Total ($ Million)	$1,181	+ $ 69	+$ 124
30-Day Visible Supply ($ Million)	$2,806	– $173	+$ 996
Total	$3,987	– $104	+$1,120
Corporates:			
Moody's Aa Composite (10/20/88)	9.67%	– .04	– 1.21
30-Day Visible Supply ($ Million)	$5,493	+ $635	+$1,913
Stocks:			
Dow-Jones Averages:			
Industrials	2,182.97	+ 49.79	+232.21
Transportation	937.35	+ 22.24	+188.40
Utilities	186.70	+ 3.20	+ 2.88
65 Stocks	821.21	+ 18.28	+ 98.74
N.Y.S.E. Composite Index	159.42	+ 3.96	+ 20.24
N.Y.S.E. Avg. Daily Vol. for Week (000's)	171,516	+ 24,482	–288,496

*34% Taxable equivalent 11.29%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/21/88	Week Ago
Overnight	8.19%	7.94%
1 month	8.25	8.19
3 month	8.56	8.50
6 month	8.56	8.50
1 year	8.69	8.69

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/21/88)	Currency Per U.S. $	Week Ago
Belgium	37.71	38.16
Canada	1.2029	1.2049
France	6.1545	6.2030
Germany	1.7888	1.8205
Italy	1335.00	1357.25
Japan	126.73	127.58
Mexico	2273.00	2273.00
Netherlands	2.0185	2.0525
South Korea	705.60	710.30
Switzerland	1.5150	1.5240
Taiwan	28.74	28.90
U.K.*	1.7582	1.7465

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (10/21/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/8
	–0.5%	–3.8%

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Nevertheless, the dollar's near-term direction is not a foregone conclusion. Although unlikely, if the current slowing of the economy turns out to be just a pause, it will not be too long before the inflation bears are again "one upping" each other as to how tight monetary policy should be and at what heights interest rates will peak—expectations of which would again put some upward bounce in the dollar. Nor is it a certain bet that the August trade data are any more reflective of a new trade balance trend than the "single digit", $9.5 billion July number was; if it is not, then a limited degree of dollar strength will soon reemerge.

Even the dollar's pronounced weakness versus the mightly yen may be somewhat misleading. It could be partially related to the public offering of the third tranche of Nippon Telegraph and Telephone Corp. stock, valued at about $24 billion; it has been rumored that Japanese financial institutions may have been big sellers of dollar-denominated assets, raising funds in order to participate in what is this year's largest common stock offering. In this uncertain environment, counting the dollar out could be premature. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/19/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	233,150	− .111	+ 9.231
Loans to Depository Inst.	2,283	+ .159	+ 1.172
Float	1,751	+ .486	+ .872
Total Reserve Bank Credit	255,586	+ .104	+13.142
Treasury Deposits with Federal Reserve Banks	5,470	+ .259	− 6.721
Currency in Circulation	237,898	+ .291	+18.798
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	227,037	+ .825	+38.722
	10/19/88		
Member Bank Reserves:			
Total Reserves Held	61,226	+ 1.160	+ 3.182
Excess (Deficiency)	1,050	− .136	+ .083
Net Free Reserves	.527	+ .075	+ .085
Monetary Aggregates †		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
M1 (10/10/88)	784.5	+ 2.1	+ 4.5
M2 (10/10/88)	3,035.5	+ 1.8	+ 5.1
M3 (10/10/88)	3,864.4	+ 5.2	+ 6.3
Domestic Nonfinancial Debt (2nd Q'88)	8,654.0	+ 8.1	+ 8.8

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 10/21/88	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.44%	7.59%	7.58%
* Federal Agencies	8.07	8.35	8.50
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.95	8.33	8.71
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	8.38	8.53	8.81

‡ Finance Company Paper—Prime

5- 14 days	8.13%
15- 29 days	8.13
30- 59 days	8.13
60- 89 days	8.13
90-179 days	8.08
180-239 days	7.75
240-270 days	7.75

‡* Bankers' Acceptances

Nov.	8.07%
Dec.	8.09
Jan.	8.19
Feb.	8.19
Mar.	8.19
Apr.	8.18

‡ Industrial Paper—Prime

30- 89 days	8.14%
90-120 days	8.25

† Federal Funds Effective Rate 8.19%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'88	$ 4,824	$ 4,725	$ 4,484
Gross National Product (1982 Dollars)*	2nd Q'88	$ 3,985	$ 3,956	$ 3,823
Percent Change, Annual Rate	2nd Q'88	3.0	3.4	5.0
Change in Consumer Prices*	Sep '88n	3.6%	4.8%	3.6%
Change in MH Cost of Living Index*	Sep '88n	8.4%	2.4%	4.8%
Change in Producer Prices*	Sep '88n	4.8%	7.2%	4.8%
Civilian Employment (Thousands of Persons) †	Sep '88	115,328	115,180	112,872
Unemployment as % of Civilian Labor Force †	Sep '88	5.4%	5.6%	5.9%
Personal Income*	Aug '88	$ 4,079	$ 4,071	$ 3,804
Leading Indicators Composite Index (1967=100) †	Aug '88	193.4	192.7	191.7
Industrial Production Index (1977=100) †	Sep '88n	138.3	138.3r	131.0
Net Change in Consumer Installment Credit †	Aug '88	$ 5.44	$ 3.62	$ 4.68
U.S. Merchandise Trade Balance †	Aug '88n	−$ 12.18	−$ 9.47r	−$ 15.08
Plant and Equipment Expenditures*	4th Q'88	$444.40(a)	$440.42(a)	$406.82
Private Housing Starts (Thousands of Units)*	Sep '88n	1,453	1,431r	1,679
New Construction Expenditures*	Aug '88	$ 396.1	$ 398.3	$ 398.3
Total Business Inventories †	Aug '88n	$ 741.7	$ 735.9r	$ 682.2r
Total Business Sales †	Aug '88n	$ 494.7	$ 489.2r	$ 458.1r

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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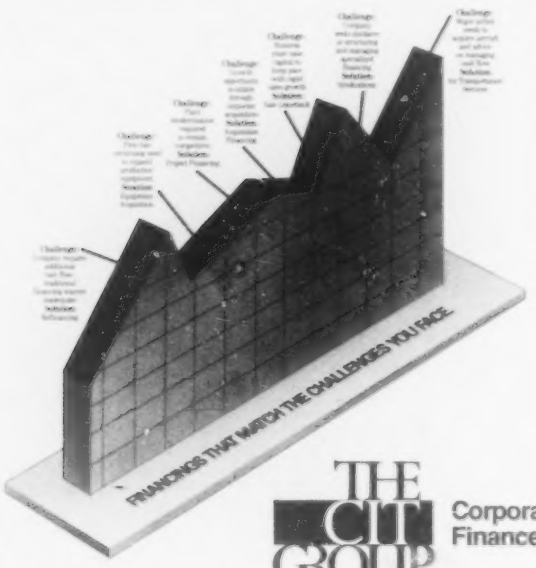

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MANUFACTURERS HANOVER

Manufacturers Hanover Corporation
Bank Window, Church St. Station
New York, N.Y. 10015

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